

RELIABLE DATA. ADVANCED TECHNOLOGIES.
MAXIMUM RETURNS.



2004 ANNUAL REPORT



PHOENIX
TECHNOLOGY INCOME FUND

PHX.UN

CORPORATE PROFILE

Our vision is to be the first-choice provider of innovative drilling technologies and services for oil and natural gas producers in Canada and the United States.

Our core values of integrity, teamwork, passion for excellence, customer focus, and social and environmental responsibility guide our actions.

Our performance values of efficiency, accountability and strong corporate governance translate into competitive operational and financial results.

ADVANCED DRILLING TECHNOLOGIES

Phoenix is a progressive directional and horizontal drilling services company, which is among the largest contractors in North America, having drilled over 5,000 wells. In addition to our drilling services, Phoenix engineers, manufactures and operates proprietary drilling guidance systems, all backed by our innovative and specialized research and development group. Phoenix combines experienced personnel, customer focus, and industry-leading technology to deliver superior project results.

Phoenix has operated in Canada since 1985 and became a publicly-traded company on March 24, 2003, which was reorganized to an income fund effective on July 1, 2004. Phoenix trades under the symbol PHX.UN on the Toronto Stock Exchange (TSX).

AGM INFORMATION

The ANNUAL GENERAL MEETING of Phoenix Technology Income Fund will be held on May 10th, 2005 from 3:00pm to 4:00pm at the Bankers Hall Auditorium, Lower Level, 315 - 8th Avenue S.W., Calgary, Alberta.

CONTENTS

Understanding our Business	3	Management's Discussion and Analysis	11
Letter to Unitholders	4	Management's Report to the Unitholders	31
Operations	8	Auditors' Report to Unitholders	32
Board of Directors	10	Consolidated Financial Statements	33

RELIABLE DATA.

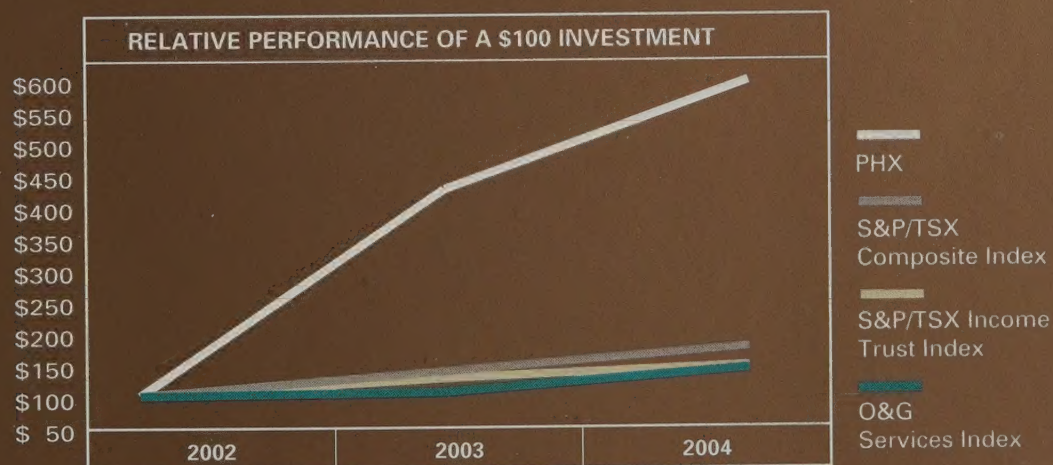
The oil and gas industry demands reliable and accurate data to ensure precision drilling. Along with conventional telemetry systems, Phoenix-developed technologies lead the sector for speed, accuracy and reliability in the transmission of data from downhole to surface, allowing precise steering of the drill bit.

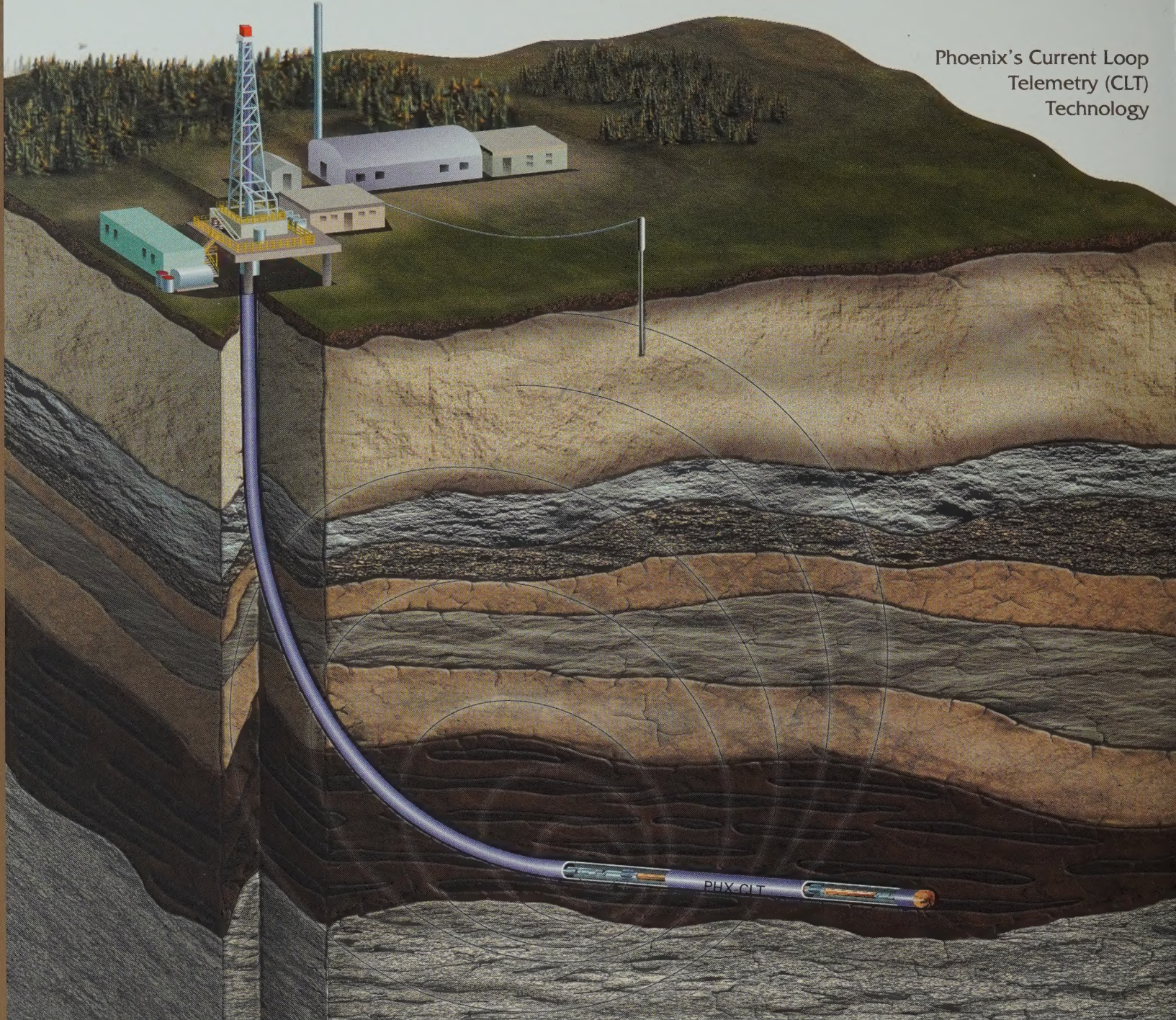
ADVANCED TECHNOLOGIES.

Phoenix operates a dedicated facility for the research and development of advanced technologies and data transmission systems for oil and natural gas drilling. The Phoenix-developed CLT system was introduced in 2003 and new technologies are in development. Phoenix manufactures its systems with a high level of quality control and reliability.

MAXIMUM RETURNS.

When Phoenix converted to an income fund on July 1, 2004 the clear intent was to maximize returns to investors. As one of the top providers of horizontal and directional drilling services in North America, Phoenix is positioned to provide unitholders with stable distributions and appreciation in its unit price.





HORIZONTAL AND DIRECTIONAL WELLS DRILLED IN CANADA



Source: Daily Oil Bulletin

UNDERSTANDING OUR BUSINESS

Directional and Horizontal Drilling:

The process of directional drilling is broken down into two specific types, directional and horizontal.

A directional well is not vertical (straight down) or horizontal (straight sideways along the horizontal plane – think of this as drilling along the horizon). A directional well can be anywhere from approximately 10° - 80° deviated from vertical. A horizontal well is defined as a well bore that builds to approximately 90° deviated from vertical, which equates to drilling on the same plane as the horizon.

Directional wells are typically used as a tool to access targets that are not directly beneath a drilling rig. A drilling rig cannot be placed directly above an oil or gas-producing target in some circumstances. Lakes, streams, environmentally-sensitive areas, cities and roadways may impede drilling at the desired location. This results in the rig being placed off of the target and having to “build” angle into the trajectory of the well bore in order to intersect the target.

Horizontal wells are designed to maximize production rates and reserve drainage. The process of drilling horizontally through an oil or gas producing formation for as long as possible increases the exposure to the hydrocarbon-bearing rock. This should in turn increase the production rates from one well bore compared to drilling vertically through the same formation.

Mud Pulse versus Phoenix’s Current Loop Telemetry (“CLT”):

In order for a driller to accurately direct a drill bit, depth, direction and formation measurements must be continuously transmitted to the surface for interpretation. Telemetry systems do this work. Mud pulse telemetry transmits downhole data to the surface by generating pressure pulses in the drilling mud or fluid; the mud acts as a “telephone line” to surface. In contrast, Phoenix’s CLT system is wireless. It transmits data to surface through specific electromagnetic frequencies.

LETTER TO UNITHOLDERS



JOHN HOOKS

Chairman of the Board,
President & CEO

Phoenix Technology Services Inc.
Manager of the Fund

In 2004, Phoenix experienced record results. It was also a year in which Phoenix converted to an income fund while continuing to aggressively build its business. The fund conversion was completed on July 1 with the strategic goal of enhancing value for our investors. Since conversion, unitholders have received monthly distributions of \$0.04 per unit, and realized a significant overall return on their holdings.

RECORD FINANCIAL RESULTS

For the full year, Phoenix set new financial benchmarks. Earnings increased to \$6.3 million, EBITDA reached \$11.4 million, and cash flow reached a high of \$10.5 million. Those results reflect particularly strong growth in our United States segment where revenues increased 55 percent over 2003, and in our JAG Rentals division, which experienced 73 percent revenue growth.

Our Canadian horizontal and directional drilling segment experienced revenue growth of 12 percent in 2004. Although this result exceeded the growth rate of 2 percent in the horizontal and directional drilling industry in western Canada in the year, the growth was still below our expectations. Phoenix experienced record revenue in the fourth quarter with a substantial increase in the provision of drilling services, which has continued into 2005. With the growth initiatives undertaken in 2004, Phoenix is well positioned to capitalize on the current robust energy environment.

RADIUS ACQUISITION

On March 9 we acquired a private company, Radius Directional Services Ltd., which helped to position Phoenix as one of North America's largest independent horizontal and directional service providers. The increased size and job capability have been only one aspect of the positive contributions of this acquisition. The Radius personnel who joined Phoenix have brought additional depth of experience and industry knowledge including expertise in the field and solid marketing skills. Over the past year those attributes have significantly strengthened our competitive advantage, and have been a valuable catalyst for increasing our customer base.

CONVERSION TO AN INCOME FUND

The conversion to an income fund on July 1, 2004, was a strategic move aimed at benefiting our unitholders, while increasing our ability to grow. From an investment point of view, the conversion has improved overall unitholders returns while increasing their liquidity.

For Phoenix, the income fund model provides a more efficient tax structure and improved market valuation of the organization. The income fund structure has allowed Phoenix to raise equity on more favorable terms. In December of 2004, we raised net proceeds of \$7.7 million through a bought-deal issue of 2,000,000 units at \$4.00 per unit. The proceeds will fund a growth-oriented capital program in 2005.

GEOGRAPHIC EXPANSION

One ongoing strategic initiative is to expand our geographic operating areas in order to lessen the dependency on the western Canadian market which experiences reduced rig activity during spring break-up. To that end, we continued to expand our United States segment, Nevis Energy Services Inc. with the opening of a facility in Casper, Wyoming to service the Rocky Mountain region. We have witnessed a rejuvenation of rig activity throughout the United States, and expect to see continued strong growth in 2005.

TECHNOLOGY

Our commitment to research and development continues to increase the strength of Phoenix in the marketplace. In 2004, the CLT system that Phoenix introduced commercially in the previous year has continued to perform exceptionally well. Manufacturing of additional systems at our Calgary facility led to 18 CLT systems in our commercial fleet at year end. Phoenix plans to manufacture an additional 15 CLT kits in 2005, bringing the CLT capability to 33 systems which can be deployed in both the Canadian and United States segments with the further potential for international deployment.

Additional Phoenix-developed technology will allow entry into new markets where there is minimal competition. One of the technologies under development, an Inclination-at-bit system, is required for steam-assisted gravity drainage (SAGD) projects, as well as being preferred in a number of additional drilling applications. This technology, and other Phoenix developed technologies are expected to become commercial in 2005, opening up large new market segments for Phoenix.

OUR EMPLOYEES ARE OUR STRENGTH

In the competitive environment in which Phoenix operates, the strength of our people is a key element to success. Industry-leading standards of consistent performance and service to our clients can be seen in every aspect of our operations. The marketing team provides a high level of support to our clients, while the experience of our operations staff translates into high standards of reliability in the field. The strength of both the research and development and manufacturing teams can be seen in the robustness and quality of our systems and equipment. I would like to personally thank all employees for their contributions in the past year.

CORPORATE HIGHLIGHTS

DECEMBER 16, 1999

Phoenix acquired the assets of Canatech Directional Drilling Services and Mepco Directional Drilling Tools Ltd., collectively known as "Canatech". Canatech provided horizontal and directional oil and gas well services throughout western Canada. The acquisition provided Phoenix additional Measurement While Drilling (MWD) guidance systems and other downhole equipment.

NOVEMBER 1, 2002

Phoenix merges with Nevis Energy Services Ltd., a publicly-listed horizontal and directional service provider in western Canada and the United States, in a reverse takeover transaction. Phoenix becomes a public company on the Canadian Venture Exchange, trading under the symbol "PHX."

MARCH 24, 2003

Phoenix lists on the Toronto Stock Exchange (TSX).

DECEMBER 31, 2003

Phoenix pays a dividend of \$0.05 per share to shareholders of record on December 17, 2003.

CORPORATE HIGHLIGHTS

MARCH 9, 2004

Phoenix acquires Radius Directional Services Ltd. and its wholly-owned subsidiary, Radius Directional Services Inc. for \$10.8 million. The acquisition expands the Company's customer and employee base as well as its fleet of guidance systems and other equipment.

JULY 1, 2004

Phoenix is reorganized into an income trust, with a yearly distribution of \$0.48 per unit (\$0.04 on a monthly basis).

LOOKING TO 2005

Phoenix is entering an exciting period in which the projected record industry environment, our internally developed technologies, and a team of experienced people will provide a springboard for substantial growth.

Phoenix is well positioned to aggressively capitalize on the resurgence of industry activity with a focus on horizontal and directional drilling applications where CLT technology is either required or preferred. Phoenix-developed technology will continue to increase our competitiveness and open new markets for expansion. Phoenix will continue to move forward with growth initiatives geographically, with the manufacture of high-performing systems to expand our service fleet, and with exceptional levels of personnel and client satisfaction.

I would like to thank the Board of Directors for their continued insight and guidance. As we move forward as an income fund, I would like to acknowledge the support of our unitholders and look forward to a year of growth and expansion.

On behalf of the Board of Directors,



John Hooks
President and Chief Executive Officer
February 18, 2005

TECHNOLOGIES AT A GLANCE

Measurement While Drilling ("MWD") – Mud Pulse Systems

For precise horizontal or directional drilling, the driller at the surface must have accurate and reliable information about the depth and direction of the well path. With mud pulse telemetry systems, information is transmitted from downhole to the surface by generating pressure pulses in the mud or fluid; the mud acts like a "telephone line".

Measurement While Drilling – Current Loop Telemetry

The Phoenix-developed Current Loop Telemetry Tool is an advanced telemetry system which can be used in certain additional drilling applications for horizontal or directional drilling. One such application is underbalanced drilling, which uses a gas mixture to reduce formation damage during drilling. This transmission can only be accomplished by utilizing electromagnetic (CLT) technology. The CLT system is wireless and has no moving mechanical parts, ensuring high performance under demanding conditions.

Technologies Under Development

INCLINATION-AT-BIT

The inclination-at-bit tool under development by Phoenix will allow more accurate steering of the well path and is ideal for SAGD drilling applications. This technology is now required by certain oil and gas operators. The inclination sensor is located near the drill bit rather than in the more typical configuration of 10-15 metres behind the bit. This system should be ready for field-testing in the first half of 2005.

EXTENDED REACH

In certain rock formations, electromagnetic telemetry signals cannot be transmitted. The Extended Reach tool under development by Phoenix will alleviate this problem. An antenna extends through the trouble formation allowing communication to the surface. Field testing is expected to be ongoing throughout 2005.

FOCUSED GAMMA

When drilling horizontally through thin zones it may be necessary to determine rock formation changes. Focused Gamma will accomplish this by determining the source direction of natural radioactive levels in rock formations. The Focused Gamma External Shield being developed by Phoenix is a device that will fit on the outside of an MWD pressure barrel and will shield one side of the tool from natural gamma rays. The main applications for the Focused Gamma External Shield are intended to be coalbed methane gas and horizontal wells.

CANADIAN SEGMENT



Phoenix Technology Services LP

Headquartered in Calgary, Alberta, the Canadian MWD/CLT operations provide horizontal and directional drilling services to oil and gas companies across western Canada.

In March 2004, Phoenix acquired Radius Directional Services Ltd., a private horizontal and directional services company that had been operating in western Canada. Phoenix's strong marketing personnel, combined with additional Radius personnel, have been instrumental in expanding Phoenix's client base.



JAG Rentals

JAG Rentals, a wholly-owned division of Phoenix, rents downhole equipment to oil and gas companies operating in western Canada. Rentals are on an hourly or daily basis for such tools as performance downhole drilling motors, drilling jars, shock tools, and stabilizers. The Division experienced significant growth in 2004 with revenues up 73 percent over 2003 to \$1.9 million due to past capital investment and increased marketing efforts. The Division is based out of a facility in Calgary.

UNITED STATES SEGMENT



Nevis Energy Services Inc.

Nevis Energy Services Inc., has continued to report strong growth since it was acquired by Phoenix in late 2002. Nevis provides fully-staffed directional and horizontal drilling services as well as MWD rentals to companies throughout the US including Texas and the Rocky Mountain states of Colorado and Wyoming. The head office and service facility is located in Houston, which includes sales, operations and field staff. In 2004, Nevis recently opened a second facility with marketing and operational personnel in Casper, Wyoming to better service and provide a platform for growth in the Rocky Mountain Region.

In 2004, revenues increased by 55 percent over 2003 to \$13.3 million. For the year, Nevis accounted for 30 percent of Phoenix's consolidated revenue. The revenue growth is reflected in Nevis' client base and activity throughout the past year. In 2004, the United States Division added CLT systems to its fleet, providing additional growth opportunities.

EQUIPMENT FLEET

A key goal of marketing and operations is to increase our client base and customer satisfaction. The deployment of the Phoenix-developed CLT system which was introduced in 2003 contributed to achieving this goal by adding to the existing fleet a tool that operates at lower cost and in additional drilling environments, which increased the growth of our client base. CLT services provide clients with greater speed and reliability of data. Phoenix is one of a few companies that offers this form of technology. As a result, it is aggressively pursuing markets where demand is increasing: steam assisted gravity drainage (SAGD), heavy oil, coalbed methane (CBM) and shallow gas drilling. At year end, Phoenix had 18 CLT systems in operation, with another 15 scheduled for manufacture and deployment in 2005. In addition, Phoenix maintains a fleet of 32 pulse MWD systems of which 26 are positive pulse, retrievable MWD systems.

*Phoenix's Research
and Development Lab
located in
Calgary, Alberta.*



BOARD OF DIRECTORS

**Board members from
left to right:**

James K. Gray,
Jeff Lawson (standing),
Randolf M. Charron,
Elson J. McDougald,
James Cameron Bailey,
John M. Hooks



John M. Hooks,
*Chairman of the Board of
Directors, President and Chief
Executive Officer*

John Hooks has been the President and CEO of Phoenix Technology Income Fund since 1995 and Chairman of the Board of Phoenix since 2000. Mr. Hooks has over thirty years of experience in the Canadian and international oil and gas service industry, including operations, senior management and ownership positions.

J.G. (Jeff) Lawson,
Director

Mr. Lawson is a Partner in the law firm of Burnet, Duckworth & Palmer LLP, a Canadian law firm with offices in Calgary, Alberta, where his practice is focused on merger and acquisition activities and corporate finance.

James K. Gray,
Director

Mr. Gray has been engaged in the oil and natural gas exploration business in western Canada for the past fifty years. In 1973, Mr. Gray co-founded and served as Executive Vice President, President, CEO, and Chairman at Canadian Hunter Exploration Ltd., one of Canada's larger natural gas producers. Mr. Gray serves on the board of various companies and participates in a wide range of community activities and projects.

Elson J. McDougald,
Director

Mr. Elson McDougald is a co-founder, President, CEO and a director of Western Lakota Energy Services Inc., an oil and gas well drilling contractor. In addition, Mr. McDougald is a director of Canadian Chemical Reclaimers, 3MC Stock Farms, and Malibu Engineering and Software Ltd.

James Cameron Bailey,
Director

Mr. Bailey is the President and CEO of SignalEnergy Inc., a publicly-traded junior oil and gas company. Mr. Bailey is a Chartered Financial Analyst who has worked in the investment business for the past 19 years.

Randolf M. Charron,
Director

Mr. Charron is President of his own private oil and gas consulting and investment company, Characo Corporation. He has worked extensively in the oil and gas service industry for over 25 years. Mr. Charron acts as director on several boards and has served on numerous committees in the oil and gas sector.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management's discussion and analysis ("MD&A") has been prepared taking into consideration information available up to February 18, 2005. The MD&A focuses on key information contained in the Consolidated Financial Statements with reference to known risks and uncertainties related to the oilfield services industry in western Canada and the United States. It should be recognized that this discussion excludes changes that may occur in economic, political and environmental conditions and consequently, this discussion should not be considered all-inclusive. The discussion and analysis of the financial condition, results of operations and cash flows should be read in conjunction with material contained in other sections of the Fund's annual report, including the audited Consolidated Financial Statements and accompanying notes.

Non generally accepted accounting principles ("GAAP") measures

The Fund uses earnings before interest, taxes, and depreciation ("EBITDA"), EBITDA per unit, cash flow, cash flow per unit and cash distributions per unit as financial performance measures that are not recognized under GAAP. Management believes that these measures provide supplemental financial information that is useful in the evaluation of the Fund's operations. Investors should be cautioned, however, that these measures should not be construed as alternatives to net income determined in accordance with GAAP as an indicator of Phoenix's performance. Phoenix's method of calculating these measures may differ from other organizations, and accordingly, these may not be comparable.

The Fund has included investment tax credit income and excluded the provision against the note receivable in its calculation of EBITDA. The Fund defines cash flow as cash provided from operations before net changes in non-cash working capital items.

Forward-looking statements

Some matters discussed in this report may be considered forward-looking statements. Such statements include declarations regarding management's intent, belief or current expectations. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties. Actual results could differ materially from those indicated by such forward-looking statements. Such risks and uncertainties include: the possible unavailability of financing, risks related to the uncertainty inherent in the oil and gas horizontal and directional services industry, the impact of energy price fluctuations, the seasonal nature of business, the dependence on third party suppliers and contractors, changes in government regulation, the impact of competition, the successful commercialization of certain technologies, the dependence upon competent employees including senior management, and fluctuations in currency exchange rates and interest rates.

DESCRIPTION OF BUSINESS

The Fund's primary business is the provision of horizontal and directional technology and drilling services in western Canada and the United States. Phoenix also manufactures Current Loop Telemetry ("CLT") guidance systems for use in its internal operations, and for lease to other horizontal and directional service providers within the industry. A tool rental division, JAG Rentals ("JAG"), provides the western Canadian oil and natural gas service industry with downhole high performance drilling motors, drilling jars, shock tools, and stabilizers. Phoenix maintains sales, service and operational centers in Calgary, Alberta, Houston, Texas, and Casper, Wyoming. The Fund's Head Office and Research and Development centers are both located in Calgary.

As at December 31, 2004, Phoenix had the capacity to run fifty concurrent jobs with thirty guidance systems deployed in Canada and twenty in the United States. The Fund currently has a fleet of eighteen CLT guidance systems. An additional fifteen CLT systems are expected to be manufactured and placed into service throughout 2005 in order to meet the high level of demand from customers. Once these additional CLT systems are placed in service, the Fund will possess a fleet of sixty-five guidance systems of which thirty-three will be CLT units.

INCOME FUND REORGANIZATION

On June 18, 2004, the shareholders and optionholders of Phoenix Technology Services Inc. ("PTSI") approved a Plan of Arrangement to reorganize Phoenix into the Phoenix Technology Income Fund, effective July 1, 2004. The reorganization was expected to improve Phoenix's access to capital to finance future growth and acquisitions, and to provide unitholders with greater liquidity and flexibility with their participation in cash flows generated in the Fund.

The Plan of Arrangement, dated May 19, 2004, was entered into by the Fund, PTSI, Phoenix Commercial Trust ("PCT") and Phoenix Acquisition Corp. ("PAC"). Pursuant to section 193 of the Alberta Business Corporations Act, the Plan of Arrangement resulted in the amalgamation of PTSI and PAC, with the successor Company named Phoenix Technology Services Inc. PTSI is a wholly owned subsidiary of PCT and PCT in turn, is a wholly owned subsidiary of the Fund.

As a result of the reorganization, each PTSI shareholder received one (1) unit of the Fund for each common share of PTSI held. A total of 18,589,855 common shares of PTSI were exchanged for the same number of units in the Fund. All optionholders exercised their vested options to acquire PTSI shares prior to the reorganization. A total of 455,609 unvested options held by optionholders to acquire PTSI shares were automatically exchanged for options to acquire units of the Fund on substantially the same terms and conditions.

OVERALL PERFORMANCE

During 2004 the Company continued to grow its operations to record levels. Revenue growth was achieved in both of Phoenix's geographical operating segments in Canada and the United States. JAG, which is incorporated in the Canadian operating segment, posted a significant

increase in its activity in 2004. Oil and natural gas commodity prices were on average at higher levels throughout 2004, as compared to 2003 and, as a result, the capital spending budgets and drilling programs of exploration and development ("E&D") companies increased in 2004. To meet increasing customer demand and to take advantage of these favourable industry conditions, the Fund increased its operating capacity in 2004 through the manufacturing of additional CLT systems, and from the acquisition of the assets and business of a private western Canadian horizontal and directional drilling services company.

Due to increases in its activity, and the reorganization of the Company into an income fund, Phoenix reported record net earnings, earnings before interest, depreciation and amortization or EBITDA and cash flow from operations in the 2004 year.

The Fund's financial position as at December 31, 2004 was further strengthened through increased activity and the closing of a private placement on December 30, 2004, whereby 2,000,000 trust units were issued at \$4.00 per unit for net proceeds of \$7.7 million. The proceeds are expected to be used to assist with the financing of the Fund's 2005 capital expenditure program.

Acquisition

In March 2004, Phoenix completed the purchase of the assets and business of a private horizontal and directional drilling services company, Radius Directional Services Ltd. and its wholly owned subsidiary Radius Directional Services Inc. (collectively, "Radius"). The operating results of Radius have been included in the consolidated operating results of Phoenix from March 9, 2004. The aggregate consideration for the acquisition was \$10.8 million, consisting of approximately \$5.5 million in cash, the assumption of \$1.8 million in debt, and the issuance of 1.15 million common shares of Phoenix at an ascribed price of \$3.05 per share. As a result of this acquisition, Phoenix has become one of North America's largest horizontal and directional drilling service providers.

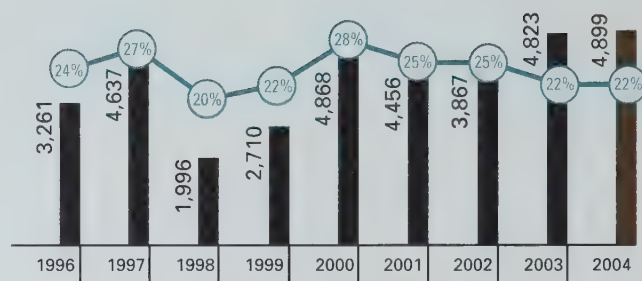
Economic and other key drivers of the Fund's business

Both current and expected oil and natural gas prices, which are largely determined by supply and demand for the commodity, drive the cash flows of E&D companies, who are our customers. The higher the level of world oil and natural gas prices, the greater the margin and cash flow generated by E&D companies, and the larger the incentive for them to conduct exploration and development drilling activities. The ability of our customers to supplement the financing of their capital expenditure programs through debt or equity issues also contributes to the level of demand for services placed upon horizontal and directional drilling service providers such as Phoenix.

During 2004 world oil prices as measured by West Texas Intermediate (WTI) averaged US \$41.51⁽¹⁾ per barrel, which was 34 percent higher than the 2003 average level of US \$30.99⁽¹⁾ per barrel. Average natural gas prices as measured by the New York Mercantile Exchange (NYMEX) increased by 7 percent in 2004 to US \$5.90⁽¹⁾ per MMBtu from the 2003 level of \$5.49⁽¹⁾ per MMBtu.

⁽¹⁾ Source Peters & Co. Limited

As a result of the increased world oil and natural gas price levels in 2004, E&D company capital expenditures were buoyant and, as a result, a record level of drilling activity in Canada was achieved. In 2004, 22,688 wells were drilled of which 22 percent, or 4,899, were drilled either horizontally or directionally. This compares to 21,914 wells drilled in 2003, with 4,823 or 22 percent of the wells being horizontal or directional. The chart



Horizontal and Directional Wells Drilled in Canada

■ Horizontal and Directional Wells Drilled
— % of Total Wells Drilled

Source: Daily Oil Bulletin

to the right depicts the number of horizontal and directional wells drilled in Canada and the ratio of horizontal and directional wells drilled to total wells drilled for the last eight years.

People, equipment reliability and technology are all key elements necessary to be successful as a service provider within the industry. The Fund's ability to attract, train and retain key personnel will directly influence its ability to increase market share. Developing and deploying new technologies, such as the Fund's CLT system, are also necessary to service the increasing demands from E&D companies for improved drilling economics.

SELECTED ANNUAL FINANCIAL INFORMATION

The following selected annual financial information was obtained from the audited consolidated financial statements prepared in accordance with GAAP:

Years ended December 31,	2004	2003	2002
<i>(Stated in thousands of dollars except per unit amounts)</i>			
Revenue	43,846	35,343	15,089
Net earnings (loss)	6,342	4,258	(1,203)
Earnings (loss) per unit – basic	0.35	0.25	(0.08)
Earnings (loss) per unit – diluted	0.34	0.25	(0.08)
Cash flow	10,492	8,475	2,006
Cash distributions made ⁽¹⁾	4,464	845	–
Cash distributions per unit ⁽¹⁾	0.24	0.05	–
Long-term liabilities ⁽²⁾	3,275	3,500	4,700
Total assets	52,554	42,489	42,103

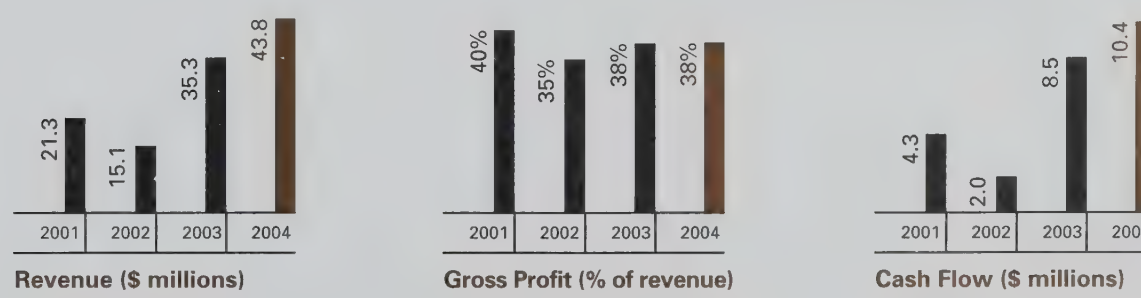
(1) Prior to converting to an income fund, Phoenix declared and paid cash dividends of \$0.05 per share or \$845,000 to its shareholders in the 2003 year.

(2) Excludes current portion of long-term debt and future income tax liability.

Revenue in 2004 increased by 24 percent from 2003 and, in turn, revenue in 2003 was 134 percent higher than 2002. The increases are attributable to increased drilling activity levels within the industry in both Canada and the United States, increases in the Funds job capacity through the addition of CLT guidance systems and two strategic acquisitions of horizontal and directional service companies in 2004 and late 2002.

Net earnings have increased in 2004 by 49 percent, as compared to 2003, due primarily to the increased activity in all areas of Phoenix's operations and the reorganization of the Company into an income fund on July 1, 2004. As an income fund, Phoenix's income tax liability is minimized through distributing the majority of its taxable income to its unitholders where the income taxes are ultimately paid. Included in net earnings for the 2004 year is a provision taken against a note receivable of \$1.2 million that related to the sale of the Well Director® assets in 2002. The collection of the note was tied to the performance of future runs of the assets. The after tax impact of this provision was \$0.9 million or \$0.05 per unit diluted. The net loss in 2002 includes a pre tax loss of \$2.4 million and a diluted per unit loss of \$0.11 per unit, from the disposition of its Well Director® assets.

Cash flow from operations, before net changes in working capital, increased 24 percent in 2004, as compared to 2003, and increased 322 percent in 2003, compared to the 2002 year. Again, the increased activity levels in 2004 and 2003 and the income fund reorganization in 2004 contributed to these increases. As a result of the income fund reorganization on July 1, 2004, Phoenix commenced monthly distributions of \$0.04 per unit on July 15, 2004, and during the 2004 year, six monthly distributions totalling \$0.24 per unit or \$4.46 million were made. In 2003 a dividend of \$0.05 per unit was paid totalling \$0.845 million.



Long-term liabilities, which are comprised of the Fund's long-term debt excluding current portion amounts, declined from 2002 to 2003 due to required repayments as per contractual agreements at that time. In 2004, the Fund issued additional long-term debt of \$1.5 million to assist with the financing of the Radius acquisition.

The increase in total assets from \$42.5 million in 2003 to \$52.6 million in 2004 is a result of the increased activity in 2004 and a private placement financing for net proceeds of \$7.7 million.

RESULTS OF OPERATIONS

Financial Highlights

(Stated in thousands of dollars except per unit amounts and units outstanding)

Years ended December 31,	2004	2003 ⁽⁴⁾	% Chg.
Operating Results			
Revenue	43,846	35,343	24
Net earnings	6,342	4,258	49
Earnings per unit – diluted	0.34	0.25	36
EBITDA	11,354	8,482	34
EBITDA per unit – diluted	0.62	0.49	27
Cash Flow			
Cash flow	10,492	8,475	24
Cash flow per unit – diluted	0.57	0.49	16
Capital expenditures ⁽¹⁾	5,366	4,354	23
Cash distributions made ⁽²⁾	4,464	845	428
Cash distributions per unit ⁽²⁾	0.24	0.05	380
Financial Position			
Working capital	12,213	13,509	(10)
Long-term debt ⁽³⁾	3,275	3,500	(6)
Unitholders' equity	39,426	28,064	40
Fund units outstanding	20,599,855	16,908,649	22

(1) Excludes business acquisitions.

(2) Prior to converting to an income trust, Phoenix declared and paid dividends of \$0.05 per share or \$845,000 to its shareholders in the 2003 year.

(3) Excludes current portion of long-term debt.

(4) For comparative purposes the dollar per share information has been converted to units on a one for one basis.

REVENUE

For the year ending December 31, 2004, the Fund generated record revenue of \$43.8 million, which was 24 percent higher than revenue of \$35.3 million in 2003. The Fund increased its operating capacity significantly in 2004 during a period of active drilling within the industry in Canada and the United States. Through the Radius acquisition and from the addition of eleven CLT systems to its fleet, the Fund's concurrent job capability increased from thirty-eight in 2003 to fifty at the end of 2004.

The Fund reports its operating segments on a geographical basis through the regions of Canada and the United States. Within the Canadian segment, the Fund had two operating divisions, measurement while drilling ("MWD") / CLT drilling services and JAG.

As a result of increasing the overall capacity in 2004, and the prolonged wet weather that occurred in the third quarter of that year, guidance equipment utilization decreased slightly to 39 percent, based on an average of 44 systems deployed in the year from 43 percent in 2003, which had on average 33 systems. Phoenix considers that the maximum achievable utilization rate to be sixty-seven percent due to the time required to mobilize and service the equipment.

Canadian Segment

Canadian segment revenue for the 2004 year increased 14 percent to a record \$30.5 million, compared to \$26.7 million in 2003. The MWD / CLT drilling services division's revenue increased by 12 percent to \$28.6 million, versus \$25.6 million in 2003. In comparison, the number of horizontal and directional wells drilled within Canada in 2004 increased by only 2 percent to 4,899 wells drilled, as compared to 4,823 in 2003. The Fund, due to wet weather conditions and an early break up in western Canada, experienced a slower first and third quarter than expected. However activity increased significantly during the fourth quarter of 2004. Included in the MWD/CLT drilling services division revenue is \$0.9 million that was generated from the sale of two CLT kits made to a horizontal and directional service provider in the United States during the first half of 2004. Due to the greater long-term profitability achieved by the Fund in leasing these systems, a decision was made not to sell further CLT systems in the year.

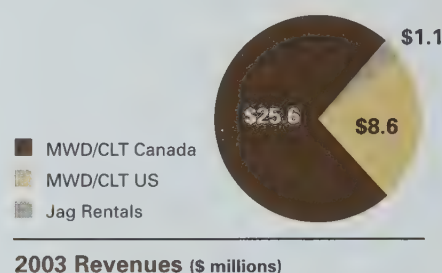
During 2004, day rate pricing remained fairly constant due to the high level of competition within the industry. The Fund is not planning for any significant pricing increases in 2005.

JAG reported record revenue of \$1.9 million for the 2004 year, as compared to \$1.1 million in 2003, a 73 percent increase. JAG's rental fleet has been continually increasing since 2003 with a greater focus made on high margin performance mud motors. The division expanded its sales force and established itself as a significant provider of services within the marketplace in 2004.

United States segment

The operations in the United States ("US") are conducted through the Fund's wholly owned subsidiary, Nevis Energy Services Inc. ("Nevis"). Despite a significant strengthening of the Canadian dollar throughout 2004, Nevis generated record revenue of \$13.3 million, 55 percent higher than 2003 revenue of \$8.6 million. Industry and customer demand throughout the US in 2004 has continued to strengthen, and the Fund deployed further guidance systems into the operation to meet the increased demand. Daily MWD / CLT system rentals comprised a significant portion of their business in both 2003 and 2004; however, it is expected that there will be a greater focus placed on full service work in 2005, which should add to the operations revenue and profitability. Nevis had on average six MWD / CLT systems under monthly leases with other horizontal and directional service providers which gave the division a stable cash flow source each month.

In order to take advantage of robust drilling activity in the rocky mountain region of the US, Nevis established a separate operations facility out of Casper, Wyoming, during 2004. It is expected that this new operating unit will allow Nevis to participate more fully in the states of Colorado and Wyoming in 2005.



The US segment made up 30 percent of the Fund's consolidated revenue in 2004, compared to 24 percent in 2003. Looking forward to 2005, it is expected that Nevis will represent approximately 24 percent of the Fund's revenue.

OPERATING COSTS AND EXPENSES

Direct Costs

These costs incorporate expenses associated with the Fund's field and shop operations and current research and development expenditures. For the 2004 year, direct costs increased by 25 percent to \$27.4 million from \$22.0 million in 2003. Gross margin, as a percentage of revenue, remained at 38 percent for both the 2004 and 2003 years. The Fund incurred additional labour costs in 2004 to meet CLT manufacturing requirements and to ensure that the rollout of the technology into the field was successful. In addition, due to customer requirements of running specialized drill bits in well applications, Phoenix was required to provide an additional field hand to service the job at rates that generated little or no margins. These higher labour costs were partially offset by lower third party guidance and motor equipment rentals in 2004. This was accomplished through the addition of CLT systems and mud motors in 2004. Research and development expenditures for the 2004 year increased to \$664,000 from \$572,000 in 2003 due to the addition of several promising projects in 2004.

Selling, general and administration ("SG&A")

SG&A costs for the year ending December 31, 2004 were \$6.0 million or 14 percent of revenue, as compared to \$5.6 million or 16 percent of revenue for the comparable 2003 year. In dollar terms, SG&A increased by 7 percent in 2004, compared to 2003. Despite the activity increase in 2004 and the addition of some SG&A from the Radius acquisition, SG&A costs did not increase significantly due to prudent and conservative spending on promotional programs and related expenses.

Depreciation and amortization

Depreciation and amortization for the 2004 year increased by 48 percent to \$4.0 million from \$2.7 million in 2003 due to the capital expenditure programs in late 2003, throughout 2004, and the Radius acquisition.

Reorganization Costs

As a result of the corporate reorganization to an income fund, costs of \$0.7 million were incurred and charged to operations in the 2004 year.

Foreign exchange gains / losses

A net foreign exchange gain of \$131,000 was reported for the 2004 year, compared to a net loss of \$661,000 in 2003. The majority of the loss in the 2003 year related to the revaluation of US \$2.5 million notes receivable that pertained to the Well Director® asset sale and a stronger Canadian dollar versus the US dollar.

Interest on long-term debt

Interest on long-term debt decreased by 10 percent in 2004 to \$207,000 from \$229,000 in 2003. The decrease is attributable to lower interest rates realized by the Fund in 2004.

Interest Income

Interest income is generated from short-term money market investments from excess cash balances held. Interest income decreased from \$225,000 in 2003 to \$106,000 in 2004, or 53 percent. This was a result of lower cash balances held throughout 2004 due to the Fund's financing requirements for capital expenditures and the Radius acquisition.

Gain on disposal of drilling equipment

The Fund realized a net gain on disposal of drilling equipment of \$413,000 in 2004, compared to \$712,000 in 2003. The disposals relate to insured equipment lost in well bores and are uncontrollable in nature.

Investment tax credits

During the 2004 year, the Fund recognized a \$1,184,000 income benefit associated with future investment tax credits. In 2003, a \$759,000 income benefit was recognized. These tax credits relate to past years' scientific research expenditures made by the Fund and were assessed by Canada Customs and Revenue Agency during 2004. The portion of the investment tax credit associated with Well Director® expenditures was \$1,039,000 in 2004 and \$702,000 in 2003. These amounts have been disclosed under the classification of investment tax credits on the statement of earnings.

Income taxes

The Fund reported a net recovery of income taxes for the 2004 year of \$0.3 million, compared to a net provision for income taxes of \$1.6 million in 2003. The income tax recovery results primarily from the reorganization of the Corporation into an income fund. Declared cash distributions are deductible in calculating taxable income of the Fund. As an investment trust, the Fund is subject to income taxes under the Income Tax Act only on income not distributed to its unitholders. In addition, the Fund benefited from the fact that a portion of gains realized on the disposal of assets were non-taxable.

EBITDA and net earnings

EBITDA for 2004 was a record \$11.4 million, \$0.62 per unit diluted, compared to 2003 EBITDA of \$8.5 million, \$0.49 per unit diluted, a 34 percent increase. Net earnings for 2004 was also a record for the Fund and increased by 49 percent to \$6.3 million, \$0.34 per unit diluted in 2004, as compared to \$4.3 million, \$0.25 per unit diluted in 2003. Included in net earnings for the 2004 year is a provision taken against a note receivable of \$1.2 million that related to the sale of the Well Director® assets in 2002. The collection of the note was tied to the performance of future runs of the assets. The after tax impact of this provision was \$0.9 million or \$0.05 per unit diluted.

SUMMARY OF QUARTERLY RESULTS

(Stated in thousands of dollars except per unit amounts)

	Dec-04	Sept-04	Jun-04	Mar-04	Dec-03	Sep-03	Jun-03	Mar-03
Revenue	13,063	10,453	7,930	12,400	9,434	7,207	6,625	12,077
Net earnings (loss)	2,050	1,294	(33)	3,031	689	995	1,161	1,413
Earnings per unit – basic	0.11	0.07	0.00	0.18	0.04	0.06	0.07	0.08
Earnings per unit – diluted	0.11	0.07	0.00	0.17	0.04	0.06	0.07	0.08
Cash flow	4,072	2,117	281	4,022	2,261	1,806	1,862	2,546
Cash flow per unit – diluted	0.22	0.11	0.01	0.23	0.13	0.11	0.11	0.15

Activity levels in western Canada vary considerably due to seasonal weather patterns. Traditionally the first quarter of the calendar year is historically the most active for service companies due to cold weather. The ability to move heavy equipment in the Canadian oil and natural gas fields is dependent on weather conditions. As warm weather returns in the spring, the winter's frost comes out of the ground rendering many secondary roads incapable of supporting the weight of heavy equipment until they have thoroughly dried out. The duration of this "spring break-up" has a direct impact on the Fund's activity levels. In addition, many exploration areas in northern Canada are accessible only in winter months when the ground is frozen enough to support equipment. The timing of freeze up and spring break-up affects the ability to move equipment in and out of these areas. As a result, late March through May is traditionally the Fund's slowest time, and as such the operating results of the Fund will vary on a quarterly basis.

Net earnings and cash flow from operations for the quarters ended December 31, 2004, and September 30, 2004, increased substantially from comparable prior quarters due to increased activity and from the corporate reorganization into an income fund. Included in net earnings for the December 2004 quarter is a provision taken against a note receivable of \$1.2 million that related to the sale of the Well Director® assets in 2002. The collection of the note was tied to the performance of future runs of the assets. The after tax impact of this provision was \$0.9 million or \$0.05 per unit diluted in the quarter. Net earnings for the quarter ended June 30, 2004 were lower than the 2003 comparable quarter due in part to increased labour costs caused by the rollout of the Fund's CLT systems. Included in the June 30, 2003, net income result was the recognition of a \$759,000 income tax benefit associated with investment tax credits that were received relating to prior year's scientific research expenditures. A similar income tax benefit of \$1,170,000 was recognized in the quarter ended March 31, 2004.

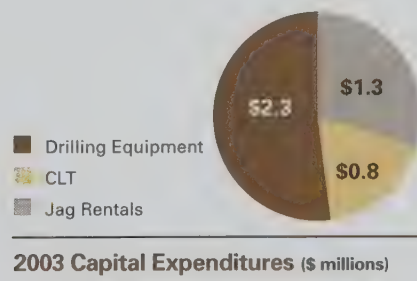
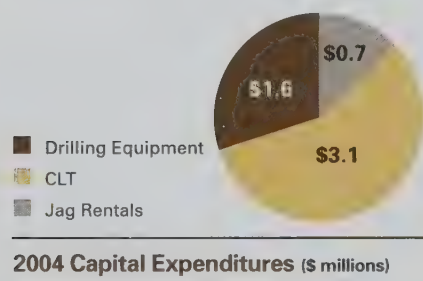
LIQUIDITY

Cash flow from operations

Cash flow from operations, before net changes in non-cash working capital, for the 2004 year was \$10.5 million, \$0.57 per unit diluted, compared to \$8.5 million, \$0.49 per unit diluted. This represents an increase of 24 percent. The reorganization into an income fund that took place on July 1, 2004, positively impacted cash flow during the second half of 2004 due to the fact that cash distributions made or declared to unitholders are allowable deductions in computing income taxes payable by the Fund.

Investment

In 2004 Phoenix incurred \$9.9 million in net cash investment expenditures, as compared to \$1.5 million in 2003. Investment in drilling and other equipment in 2004 was \$5.4 million which was comprised of \$3.1 million in manufactured CLT systems and other associated equipment, \$0.7 million in JAG fleet additions, and a further \$1.6 million in other drilling equipment including mud motors and drill collars. The Fund realized proceeds from the involuntary disposal of drilling equipment in well bores of \$0.9 million in 2004 and, as a result, the net cash expenditures in drilling and other equipment for 2004 was \$4.5 million. The 2003 expenditures of \$4.4 million were comprised of \$1.3 million in JAG fleet additions, \$0.8 million in CLT system additions and \$2.3 million in other drilling equipment. The net cash expenditures in 2003 were \$2.3 million after recognizing proceeds of involuntary drilling equipment disposals of \$2.1 million.



In 2004 the Fund invested \$5.5 million cash to assist with the financing of the \$10.8 million Radius acquisition. This acquisition and capital expenditures were made out of the Fund's cash flow from operations and from working capital. In 2003, the Fund collected a note receivable of \$0.7 million relating to the Well Director® asset sale.

Financing

The Fund generated cash flow from net financing activities of \$0.8 million for the 2004 year, compared to a net cash outflow of \$3.9 million for the 2003 year. 2004 cash flows were generated from the issue of Fund units for a total of \$8.0 million and long-term debt for \$1.5 million. The Fund issued 2,000,000 units at \$4.00 per unit on a bought deal basis on December 30, 2004, for gross cash proceeds of \$7.7 million. The remainder of the proceeds generated on issuance of units were from the exercise of unit options. Long-term debt of \$1.5 million was issued to assist with the financing of the Radius acquisition. In 2003 Phoenix, through a normal course issuer bid, repurchased 439,400 common shares at an average price of \$1.30 per share.

In 2004, the Fund made long-term debt repayments of a total of \$3.2 million; \$1.8 million of this related to high interest yielding debt assumed from the Radius acquisition. In 2003 regular contractual debt repayments of \$1.2 million were made.

As an income fund, Phoenix commenced distributions to unitholders on July 15, 2004 and for the period ending December 31, 2004 a total of \$4.5 million or \$0.24 per unit in cash distributions were made. In 2003, Phoenix declared and paid a dividend on its common shares at that time of \$0.8 million or \$0.05 per share.

In 2002, a group of shareholders, holding in aggregate 994,375 Common Shares of Phoenix Technology Services Ltd. ("PTSL"), a subsidiary of PTSI, exercised their right to dissent under the Plan of Arrangement and consequently these shares were cancelled. These former shareholders of PTSL were entitled to be paid fair value for their shares. On April 15, 2004, the Fund reached a final settlement. Payments made to these dissenting shareholders and associated costs with the dissent process in an amount equal to the par value related to those shares, were deducted from share capital, net of taxes, in the amount of \$1.4 million in 2003. In 2004, remaining payments and associated costs of \$1.1 million were in excess of the par value of the related shares, and accumulated earnings were adjusted accordingly.

Working capital and liquidity

As at December 31, 2004 and 2003 the Fund had working capital of \$12.2 million and \$13.5 million respectively. Working capital was used throughout 2004 to assist with the financing of the Fund's capital expenditures and business acquisition, but it was effectively replenished from the private placement financing at the end of the 2004 year. Phoenix anticipates that it will be able to fund its 2005 capital expenditure program through a portion of its cash flow from operations, its working capital, and the utilization of its unused debt capacity if required. It is also anticipated that the Fund can generate sufficient cash flow from operations to allow it to maintain its current cash distribution rate to unitholders.

Circumstances could arise that could adversely affect the Fund's cash flow from operations. These would include reduced capital spending by E&D companies and decreasing world oil and natural gas commodity prices. Refer also to the "Business Risk Factors" section. If an unexpected downturn in activity did occur, the Fund would react quickly to modify its capital expenditure program and strategies accordingly.

Activity levels in the industry are also seasonal as discussed in the "Summary of Quarterly Results" section, and as a result cash flow from operations will fluctuate. Cash flows from operations are usually expected to be highest in the first quarter of the year and lowest in the second quarter due to weather patterns.

CONTRACTUAL OBLIGATIONS

The Fund has various contractual obligations outstanding that have been incurred in the normal course of operations:

	Total	1 Year	2-3 Years	4-5 Years
Long-term debt	\$ 4,775,000	\$ 1,500,000	\$ 2,900,000	\$ 375,000
Operating leases	940,410	704,793	235,617	—
Purchase obligations	916,816	916,816	—	—
Total contractual obligations	\$ 6,632,226	\$ 3,121,609	\$ 3,135,617	\$ 375,000

The purchase obligations are commitments that were outstanding as at December 31, 2004 for capital equipment.

CAPITAL RESOURCES

The Fund has access to a demand revolving loan facility of up to \$5.0 million. This facility would bear interest at the bank prime rate plus 0.375 percent. No amounts on the facility were drawn as at December 31, 2004. The Fund also has access to a revolving loan facility of up to \$1,870,000 to be used to assist in the acquisition of capital assets. The loan would bear interest at the Fund's option at the bank prime rate plus 0.50 percent, or at the bank's banker's acceptance rate plus a stamping fee of 1.25 percent. As at December 31, 2004, the Fund was in compliance with all of its bank debt covenants.

The Fund has outstanding purchase obligations for capital assets of \$0.9 million as of December 31, 2004. The obligations are comprised of additional manufactured CLT systems and other drilling equipment. The Fund plans to incur total capital expenditures of \$8.7 million in 2005 that will be financed primarily from working capital.

OFF BALANCE SHEET ARRANGEMENTS

The Fund had no off balance sheet arrangements as at December 31, 2003 and 2004.

TRANSACTIONS WITH RELATED PARTIES

During the year the Fund was charged \$623,977 (2003 – \$209,787) for the provision of various legal services from a director's firm of which he is a partner. In addition, the Fund received \$59,932 (2003 – nil) for various services performed and \$10,600 (2003 – nil) for the sale of various capital equipment from, companies controlled by an officer and major unitholder of the Fund. These transactions were completed in the normal course of operations on normal market terms and are measured at the exchange amounts.

FOURTH QUARTER

Financial Highlights (unaudited)

(Stated in thousands of dollars except per unit amounts and units outstanding)

Quarter ended December 31,	2004	2003	% Chg.
Operating Results			
Revenue	13,063	9,434	38
Net earnings	2,050	689	198
Earnings per unit – diluted	0.11	0.04	175
EBITDA	3,804	1,903	100
EBITDA per unit – diluted	0.21	0.11	91
Cash Flow			
Cash flow	4,072	2,261	80
Cash flow per unit – diluted	0.22	0.13	69
Cash distributions made ⁽¹⁾	2,232	845	164
Cash distributions per unit ⁽¹⁾	0.12	0.05	140

⁽¹⁾ Prior to converting to an income trust, Phoenix declared and paid dividends of \$0.05 per share or \$845,000 to its shareholders in the 2003 year.

Revenue

On the strength of industry drilling activity and demand for Fund services in both Canada and the US in the quarter, and from increased capacity through CLT system additions and the Radius business acquisition, Phoenix generated record period revenue of \$13.1 million for the quarter ending December 31, 2004, compared to \$9.4 million for the comparable 2003 period, an increase of 38 percent. Canadian segment revenue for the quarter ended December 31, 2004, was \$9.7 million or 31 percent higher than the corresponding 2003 period's revenue of \$7.4 million. Within the Canadian segment, MWD / CLT drilling services revenue increased 29 percent from \$7.0 million in the 2003 quarter to \$9.0 million in 2004. In comparison, the activity in Canada during the fourth quarter of 2004, measured by the number of horizontal and directional wells drilled, increased by 9 percent to 1,423 wells from 1,308 wells in the 2003 quarter.

JAG's revenue for the quarter ending December 31, 2004, increased by 75 percent to \$0.7 million from \$0.4 million for the comparable 2003 period. Within the US segment, revenue increased by 70 percent to \$3.4 million for the 2004 quarter, as compared to \$2.0 million in the corresponding 2003 quarter.

Gross profit and operating costs

Gross profit, as a percentage of revenue, was 39 percent for both quarters ending December 31, 2003, and 2004. SG&A costs for the quarter ending December 31, 2004, decreased from \$1.5 million to \$1.3 million, as compared to the comparable 2003 quarter. The decrease was primarily due to expense accrual adjustments made in the 2004 quarter and lower professional fees incurred in 2004, as compared to the 2003 period. As a percentage of revenue, SG&A declined from 16 percent in the 2003 period to 10 percent in the 2004 period.

Income taxes

The Fund reported a net recovery of income taxes for the quarter ending December 31, 2004, of \$0.5 million compared to a net provision for income taxes of \$0.5 million in the comparable 2003 quarter. The income tax recovery results primarily from Phoenix's operation as an income fund. Declared cash distributions are deductible in calculating taxable income of the Fund.

EBITDA and net earnings

Due to increased activity, EBITDA for the quarter ending December 31, 2004, was \$3.8 million, \$0.21 per unit diluted, compared to \$1.9 million, \$0.11 per unit diluted for the corresponding 2003 quarter, a 100 percent increase. Aided by the reorganization of Phoenix into an income fund and higher levels of activity, net earnings for the quarter ending December 31, 2004, increased by 198 percent to \$2.1 million, \$0.11 per unit diluted, compared to \$0.7 million, \$0.04 per unit diluted in the 2003 quarter. Included in net earnings for the December 2004 quarter is a provision taken against a note receivable of \$1.2 million that related to the sale of the Well Director® assets in 2002. The collection of the note was tied to the performance of future runs of the assets. The after tax impact of this provision was \$0.9 million or \$0.05 per unit diluted in the quarter.

Cash flow from operations

The Fund reported cash flow from operations, before net changes in non-cash working capital, of \$4.1 million, \$0.22 per unit diluted for the quarter ending December 31, 2004, compared to \$2.3 million and \$0.13 per unit diluted. Cash distributions made to unit holders in the 2004 fourth quarter totalled \$0.12 per unit or \$2.2 million. This translated into a cash payout ratio, cash distributions divided by cash flow from operations, of 55 percent.

PROPOSED TRANSACTIONS

The Fund currently has no plans to make any material business acquisitions or capital asset divestitures. As mentioned in the "Capital Resources" section, the Fund has plans to acquire \$8.7 million in capital assets in 2005.

CRITICAL ACCOUNTING ESTIMATES

The consolidated financial statements of the Fund are prepared in accordance with GAAP. The Fund's significant accounting policies are described under note 1 to these statements. Management, in preparing these financial statements, are required to make estimates and judgements that affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and judgements are based upon assumptions that are considered reasonable under the circumstances. Actual results could differ from such estimates and judgements by a material amount. The estimates and judgements used that are most critical to the reporting of the Fund's results of operations, cash flow and financial position are as follows:

Accounts receivable

The Fund's trade accounts receivable accounts are reviewed on an ongoing basis for collectability. The Fund makes an allowance for specific accounts that are deemed to be uncollectable. Due to the nature of exploration risks taken on by E&D companies, the ability of these companies to fulfill their obligations can change quickly and the valuation of accounts receivable may become impaired.

Note receivable

The collection of the note receivable was tied to future performance runs of the Well Director® by the purchaser of these assets from the Fund. These runs had to occur before May 1, 2005. It is estimated that the performance run criteria will not be met and as result, a full provision against the note was taken in the 2004 year. As the future runs and operations of these assets are not controlled by the Fund, there is still the possibility that the run criteria would be met by May 1, 2005 and the note collected.

Depreciation of drilling and other equipment

The Fund has estimated the useful lives and residual values of its drilling and other equipment. The Fund has also estimated the depreciation method that best reflects the utilization pattern of the various assets. These estimates can change as technological advancements are made within the industry and adjustments may become necessary.

Intangibles

The Fund has estimated the existence of, and provided a valuation for, other intangible assets on its acquisition in the year. The identification and valuation of intangible assets was based on certain assumptions and analysis that the Fund deemed to be reasonable in the circumstances. The amortization of these assets are being charged to operations over the expected benefit period of two years.

Goodwill

Goodwill is not amortized, and is tested for impairment annually in December of each year. Management of the Fund has determined that there has been no impairment on the carrying value of goodwill as at December 31, 2004. Due to the cyclical nature of the industry, goodwill valuations could be materially different in the future.

Income taxes

The Fund follows the liability method of accounting for income taxes. Under the liability method, future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Valuation allowances are taken against future tax assets when it is determined that it is more likely than not that the asset will not be realized in its entirety. The Fund has taken its forecasted future income tax liability into consideration in determining if a valuation allowance is required with respect to tax loss carry forward amounts. The Fund has also recorded benefits associated with investment and foreign business tax credits received. The Fund's forecasted future income tax liability was again considered in determining if these amounts would be realizable. Due to the cyclical nature of the industry, the Fund's future forecasted income tax liability could change, and the realization of these assets in whole or in part may not occur.

Translation of foreign subsidiary

The Fund's US subsidiary is accounted for as a self-sustaining operation. Accordingly, the subsidiary's accounts in foreign currencies and operations have been translated into Canadian dollars using the current rate method. Monetary and non-monetary items denominated in US dollars are translated to Canadian dollars at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at the average exchange rate for the month the transaction occurred. Gains or losses arising on translation are deferred and reported as a foreign currency adjustment as a separate component of unitholders' equity. Circumstances can change in the future whereby the subsidiary could be classified as fully integrated and, as a result, gains or losses arising on translation would be charged or credited against net earnings.

CHANGES IN ACCOUNTING POLICIES

There have been no changes in accounting policies subsequent to December 31, 2004, and no changes are anticipated. There were no new accounting policies adopted in the 2004 year.

FINANCIAL INSTRUMENTS

Credit risk

The Fund is exposed to normal credit risks of its customers that exist within the oil and gas exploration and development industry.

Fair values of financial instruments

The carrying values of accounts receivable, accounts payable and accrued liabilities, and income taxes payable approximate their fair value due to the relatively short periods to maturity of the instruments. The fair value of long-term debt included in the consolidated balance sheet approximates fair values as the indebtedness is subject to floating rates of interest.

Interest rate risk

The Fund manages its exposure to interest rate risk through floating bankers acceptance rate borrowings.

BUSINESS RISK FACTORS

Demand for services

Demand for the Fund's horizontal and directional drilling technology and services depends largely on the level of capital spending by oil and natural gas companies for exploration, development, and production activities in western Canada and the United States. No assurance can be given that current levels of oil and natural gas drilling activities will be maintained or increase, or that demand for the Fund's technology and services will reflect the level of drilling activities. As well, exploration and development drilling activities depend in large measure upon oil and natural gas prices that may be affected by local or international factors, or by governmental regulation that cannot be accurately predicted. The business of the Fund is directly affected by changes in the level of drilling activity carried on by its customers which, in turn, is directly affected by fluctuations in world energy prices.

Competition

The Fund's major competitors are principally large multinational companies, with significantly greater resources available for marketing and research and development programs. The Fund also competes with a number of other small and medium sized companies, which, like the Fund, have certain competitive advantages such as low overhead costs and specialized regional strengths. The Fund's ability to generate revenues depends on its ability to obtain contracts and to perform services within projected times and costs.

Access to equipment and development of new technology

The ability of the Fund to compete and expand is dependent upon it having access at a reasonable cost to certain drilling equipment and CLT components, and to develop or acquire new competitive technology. The Fund will make its purchases of this equipment from time to time from various suppliers in the oil and natural gas drilling service industry. There can be no assurance that these sources for equipment will be maintained. If such equipment is not available, and is not available from any other source, the Fund's ability to compete may be impaired.

Employees

The success of the Fund will be dependent upon key personnel. Loss of the services of such persons could have a material adverse effect on the business and operations of the Fund. The ability of the Fund to expand its services is dependent upon its ability to attract additional qualified employees.

Oil and gas industry risks

There are risks associated with the provision of drilling services to the oil and natural gas industry. The Fund may become liable for risks against which it may choose not to insure due to high premium costs, or which may exceed the limits of policy coverage. Interruptions and delays caused by adverse weather conditions, equipment failures and other events can significantly adversely affect revenues. While the Fund will maintain liability insurance, the insurance is subject to coverage limits. There can be no assurance that insurance will continue to be available to the Fund on commercially reasonable terms, that the possible types of liabilities that may be incurred by the Fund will be covered by its insurance, or that the dollar amount of such liabilities will not exceed policy limits. Even a partially uninsured claim, if successful and of sufficient magnitude, could have a material adverse effect on business, results of operations and prospects.

Seasonality

In general, the level of activity of the Canadian oilfield service industry is influenced by seasonable weather patterns. Wet weather and the spring thaw may make the ground unstable. Consequently, municipalities and provincial transportation departments enforce road bans that restrict the movement of rigs and other heavy equipment, thereby reducing activity levels. Additionally, certain oil and gas producing areas are located in areas that are inaccessible, other than during the winter months, because the ground surrounding or containing the drilling sites in these areas consists of swampy terrain known as muskeg.

Foreign operations

The Fund will conduct a certain portion of its business in the United States. Any changes in government policies could have a significant impact on business in the United States. Risks of foreign operations include, but are not necessarily limited to, changes of laws affecting foreign ownership, government participation, taxation, royalties, duties, rates of exchange, inflation, exchange control, and repatriation of earnings. There are no assurances that the economic and political conditions in the countries in which the Fund operates will continue as they are at the present time. The effect of these factors cannot be accurately predicted.

OUTSTANDING FUND UNIT DATA

<i>(in thousands of units)</i>	As at December 31, 2004
Fund units – basic	20,600
Dilutive securities:	
Options	698
Fund units – diluted	21,298

OUTLOOK

Horizontal and directional drilling activity is determined by the level of current and anticipated world oil and natural gas prices. Industry analysts currently expect that world oil and natural gas prices will not change significantly from current levels, and are in fact predicting increased 2005 capital budgets for E&D companies. This should translate into an active drilling year in 2005. The Fund is currently experiencing a record level of activity during the first part of the 2005-year.

The prospects for Phoenix to further grow its business in 2005 look promising. Phoenix, through the rollout of its CLT technology, has positioned the Fund with a very strong competitive edge in the marketplace. Operating capacity in 2004 increased significantly, and Management anticipates continuing the increase of its capacity in 2005 with the addition of fifteen more CLT systems. Phoenix will explore further expansion opportunities both inside and outside North America.

MANAGEMENT'S REPORT TO THE UNITHOLDERS

The accompanying consolidated financial statements and all information in the Annual Report are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with the accounting policies in the notes to financial statements. When necessary, management has made informed judgments and estimates in accounting for transactions which were not complete at the balance sheet date. In the opinion of management, the financial statements have been prepared within acceptable limits of materiality, and are in accordance with Canadian generally accepted accounting principles (GAAP) appropriate in the circumstances. The financial information elsewhere in the Annual Report has been reviewed to ensure consistency with that in the consolidated financial statements.

Management has prepared Management's Discussion and Analysis (MD&A). The MD&A is based upon the Fund's financial results prepared in accordance with Canadian GAAP. The MD&A compares the audited financial results for the twelve months ended December 31, 2004 to December 31, 2003.

Management maintains appropriate systems of internal control. Policies and procedures are designed to give reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records properly maintained to provide reliable information for the preparation of financial statements.

KPMG LLP, an independent firm of Chartered Accountants, was engaged by Computershare Trust Company of Canada, trustee of the Fund as of May 19, 2004, to audit the consolidated financial statements in accordance with generally accepted auditing standards in Canada and provide an independent professional opinion.

The Audit Committee of the Board of Directors of Phoenix Technology Services Inc., which is comprised of three directors who are not employees of the Corporation, has discussed the consolidated financial statements, including the notes thereto, with management and external auditors. The consolidated financial statements have been approved by the Board of Directors on the recommendations of the Audit Committee.



John Hooks
Chairman of the Board, President
and Chief Executive Officer



Cameron Ritchie, CA
Senior Vice-President Finance
and Chief Financial Officer

February 18, 2005

AUDITORS' REPORT TO UNITHOLDERS

We have audited the consolidated balance sheet of Phoenix Technology Income Fund as at December 31, 2004 and 2003 and the consolidated statements of earnings and accumulated earnings and cash flows for each of the years in the two-year period ended December 31, 2004. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2004 and 2003 and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2004 in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Calgary, Canada

February 18, 2005

CONSOLIDATED BALANCE SHEETS

December 31, 2004 and 2003

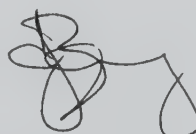
	2004	2003
ASSETS		
Current assets		
Cash and cash equivalents	\$ 5,933,924	\$ 7,547,533
Accounts receivable	12,307,097	9,406,962
Inventory (note 4)	871,316	614,938
Prepaid expenses	448,722	278,892
Income taxes recoverable	265,200	1,275
Note receivable	-	1,944,750
Investment tax credit receivable	-	759,000
	19,826,259	20,553,350
Drilling and other equipment (note 5)	22,163,871	16,894,690
Intangibles	300,000	-
Goodwill	8,876,351	3,744,731
Investment tax credit receivable	1,387,471	-
Note receivable	-	1,296,500
	\$ 52,553,952	\$ 42,489,271
LIABILITIES AND UNITHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	\$ 5,289,273	\$ 5,844,371
Distributions payable (note 8)	823,994	-
Current portion of long-term debt (note 9)	1,500,000	1,200,000
	7,613,267	7,044,371
Long-term debt (note 9)	3,275,000	3,500,000
Future income taxes (note 10)	2,239,200	3,881,000
	13,127,467	14,425,371
Unitholders' equity		
Unitholders' capital (note 11)	32,386,415	-
Share capital (note 11)	-	20,624,493
Contributed surplus (note 12)	654,900	519,416
Foreign currency adjustment	(1,624,827)	(1,104,302)
Accumulated earnings	13,297,556	8,024,293
Accumulated cash distributions (note 8)	(5,287,559)	-
	39,426,485	28,063,900
Contingency (note 20)		
	\$ 52,553,952	\$ 42,489,271

See accompanying notes to the consolidated financial statements.

Approved on behalf of Phoenix Technology Income Fund by Phoenix Technology Services Inc.
as administrator:



John Hooks
Chairman of the Board



Cameron Bailey
Director

CONSOLIDATED STATEMENTS OF EARNINGS

Years ended December 31, 2004 and 2003

	2004	2003
Revenue	\$ 43,846,449	\$ 35,342,521
Direct costs	27,400,521	21,989,102
Gross profit	16,445,928	13,353,419
Expenses		
Selling, general and administrative	6,017,126	5,625,091
Depreciation and amortization	4,007,341	2,666,595
Reorganization costs (note 13)	657,616	—
Foreign exchange loss (gain)	(130,941)	660,703
Interest on long-term debt	207,120	228,827
Interest income	(106,100)	(224,517)
Gain on disposition of drilling equipment	(412,865)	(712,176)
	10,239,297	8,244,523
Operating income	6,206,631	5,108,896
Provision against note receivable (note 14)	1,202,000	—
Investment tax credit income	(1,039,000)	(702,000)
Earnings before income taxes	6,043,631	5,810,896
Provision for (recovery of) income taxes (note 10)		
Current	477,700	113,500
Future	(776,000)	1,439,000
	(298,300)	1,552,500
Net earnings	\$ 6,341,931	\$ 4,258,396
Earnings per unit – basic (note 11b)	\$ 0.35	\$ 0.25
Earnings per unit – diluted (note 11b)	\$ 0.34	\$ 0.25

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF ACCUMULATED EARNINGS

Years ended December 31, 2004 and 2003

	2004	2003
Accumulated earnings, beginning of year	8,024,293	4,611,331
Net earnings	6,341,931	4,258,396
Amounts paid in excess of assigned value on cancellation of common shares (note 11d)	(1,068,668)	—
Dividends paid	—	(845,434)
Accumulated earnings, end of year	\$ 13,297,556	\$ 8,024,293

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2004 and 2003

	2004	2003
Cash flows from operating activities		
Net earnings	\$ 6,341,931	\$ 4,258,396
Add (deduct) items not affecting cash		
Depreciation and amortization	4,007,341	2,666,595
Future income taxes	(776,000)	1,439,000
Unrealized foreign exchange (gain) loss	(40,190)	660,703
Gain on disposition of drilling equipment	(412,865)	(712,176)
Stock-based compensation (note 11c)	170,039	83,614
Provision against note receivable	1,202,000	—
Loss on note receivable	—	78,975
	10,492,256	8,475,107
Change in non-cash working capital (note 15)	(2,941,702)	(3,376,600)
	7,550,554	5,098,507
Cash flows from investing activities		
Proceeds on disposition of drilling equipment	923,777	2,105,356
Acquisition of drilling and other equipment	(5,366,376)	(4,354,168)
Business acquisition (note 3)	(5,503,803)	—
Notes receivable	—	709,825
	(9,946,402)	(1,538,987)
Cash flows from financing activities		
Issuance of units	8,040,868	35,998
Issue of long-term debt	1,500,000	—
Repayment of long-term debt	(3,226,396)	(1,200,000)
Distributions to unitholders' (note 8)	(4,463,565)	—
Dividends paid	—	(845,434)
Dissenting shareholder disbursements (note 11d)	(1,068,668)	(1,383,651)
Repurchase of units	—	(474,524)
	782,239	(3,867,611)
Decrease in cash and cash equivalents	(1,613,609)	(308,091)
Cash and cash equivalents, beginning of year	7,547,533	7,855,624
Cash and cash equivalents, end of year	\$ 5,933,924	\$ 7,547,533
Supplemental information		
Income taxes paid (received)	\$ (64,023)	\$ 186,695
Interest paid	\$ 174,546	\$ 226,386

See accompanying notes to the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2004 and 2003

Phoenix Technology Income Fund (the "Fund") is an unincorporated open-ended investment trust governed by the laws of the province of Alberta pursuant to a Trust Indenture dated May 19, 2004 between Phoenix Technology Services Inc. ("PTSI") and Computershare Trust Company of Canada. Pursuant to section 193 of the Alberta Business Corporations Act, a Plan of Arrangement was entered into by the Fund, PTSI, Phoenix Commercial Trust ("PCT"), Phoenix Acquisition Corp. ("PAC"), effective July 1, 2004, whereby PTSI amalgamated with PAC and the successor Company changed its name to Phoenix Technology Services Inc. (the "Company"). The Company is a wholly owned subsidiary of PCT, and PCT is in turn a wholly owned trust of the Fund.

The Fund through its subsidiaries and partnership provides horizontal and directional drilling services to the oil and natural gas industry in western Canada and the United States. The Fund also rents various drilling equipment to oil and natural gas companies in western Canada and manufactures technology for lease and internal use.

1. SIGNIFICANT ACCOUNTING POLICIES:

(a) Revenue recognition

The Fund recognizes revenue as services are provided. The Fund's services are sold based upon bid acceptances or contracts with customers that include fixed or determinable prices based upon daily, hourly or job rates. Revenue is recognized when services or equipment rentals are provided and when collectibility is assured.

(b) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand with commercial banks and investments in bankers acceptances issued by commercial banks and large corporations with an original maturity of three months or less.

(c) Inventory

Inventory is stated at the lower of cost and net realizable value, cost being determined on a specifically identified basis.

(d) Drilling, other equipment and depreciation

Drilling and other equipment are recorded at cost. Depreciation is provided over the estimated useful lives of the assets as follows:

Directional drilling equipment	4 to 8 years straight line, 0 to 20% residual value
Rental equipment	5 to 8 years straight line, 0 to 20% residual value
Office and computer equipment	3 to 5 years straight line
Machinery and equipment	5 years straight line
Vehicles	5 years straight line

(e) Research and development costs

Research costs are expensed as incurred. Certain product development costs are capitalized once market and technical feasibility has been established. Development costs capitalized are amortized on a straight-line basis over their estimated useful lives once commercial production or use of the product occurs. The Fund reviews the recoverability of capitalized development costs on an annual basis to determine if there has been a permanent impairment. The un-amortized portions of these costs are written off in the year where there has been an impairment in value. Equipment acquired to conduct research and development activities are capitalized and amortized over their estimated useful lives.

(f) Intangibles

Intangibles, consisting of non-competition agreements, are recorded at cost and amortized on a straight-line basis over their useful lives of two years.

(g) Goodwill

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed, based on the fair values.

Goodwill is not amortized and is tested for impairment annually in the fourth quarter, or more frequently if events or changes in circumstances indicated that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting segment is compared to its fair value. When the fair value of the reporting segment exceeds its carrying amount, goodwill of the reporting segment is considered not to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying amount of the reporting segment's goodwill exceeds its fair value, in which case the implied fair value of the reporting segment's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. The Fund has conducted its annual goodwill assessment and determined there was no impairment for 2004.

(h) Long-lived assets

Management assesses the carrying value of long-lived assets on a periodic basis for indications of impairment. Indications of impairment include an ongoing lack of profitability and significant changes in technology. When an indication of impairment is present, a test for impairment is carried out by comparing the carrying value of the asset to its net recoverable amount. If the carrying amount is greater than the net recoverable amount, the asset would be written down to its estimated fair value. In 2004 there were no indications of impairment.

(i) Foreign currency translation

The Fund's United States ("US") subsidiary is accounted for as a self-sustaining operation. Accordingly, the subsidiary's accounts in foreign currencies and operations have been translated into Canadian dollars using the current rate method. Monetary and non-monetary items denominated in US dollars are translated to Canadian dollars at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at the average

exchange rate for the month the transaction occurred. Gains or losses arising on translation are deferred and reported as a foreign currency adjustment as a separate component of unitholders' equity.

Transactions denominated in a currency other than Canadian dollars are translated by applying exchange rates in effect at the transaction date. At the end of the year, monetary assets and liabilities denominated in a foreign currency are translated using the exchange rate as at that date. Any resulting foreign exchange translation gains and losses are charged to earnings for the year.

(j) Per unit amounts

Basic per unit amounts are calculated using the weighted average number of fund units outstanding during the period. Diluted per unit amounts are calculated using the treasury stock method where deemed proceeds of the exercise of unit options are considered to be used to re-acquire fund units at an average unit price. The weighted average number of units outstanding is then adjusted by the net change.

(k) Income taxes

The Fund is a mutual fund trust for purposes of the *Income Tax Act* (Canada) and is only subject to income taxes on taxable income not distributed to the unitholders. The Company continues to be subject to certain provincial capital taxes and corporate income taxes, and follows the liability method of accounting for income taxes.

(l) Stock-based compensation plans

The Fund has a unit option plan which is described in note 11(c). Commencing in 2003, the fair value of unit options are expensed over the vesting period. For stock options issued prior to 2003, pro forma disclosure of the effect on net earnings and earnings per unit had the fair value been expensed is provided. The fair value of unit options that have been expensed is credited to contributed surplus.

(m) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for the year. Actual results could differ from such estimates by a material amount.

(n) Comparative figures

Certain comparative figures have been reclassified to conform to current year's financial statement presentation.

2. CHANGE IN ACCOUNTING POLICIES:

(a) Stock-based compensation

Effective January 1, 2003 the Fund expensed stock options on a prospective basis. Prospective adoption requires that the fair value of compensation costs related to stock options granted in 2003 be expensed in the financial statements over the vesting period. For stock options granted prior to 2003, the Fund will continue to provide pro forma disclosure of the effect on net earnings and earnings per unit had the fair value been expensed.

(b) Foreign currency translation

Effective January 1, 2003, the designation of the Fund's foreign subsidiaries was changed from fully integrated to self-sustaining. Accordingly, the subsidiaries accounts in foreign currencies and operations have been translated into Canadian dollars using the current rate method. As the change in classification is due to the reorganization of the US subsidiaries acquired prior to 2003, it has been accounted for prospectively.

3. ACQUISITION:

On March 9, 2004, the Fund completed the acquisition of the assets and the business of a private horizontal and directional drilling services company, Radius Directional Services Ltd., and its wholly owned subsidiary Radius Directional Services Inc. ("Radius"). Radius offered horizontal and directional drilling services throughout western Canada.

The acquisition was accounted for using the purchase method. The details of which were as follows:

Consideration:	
Cash (including transaction costs of \$70,768)	\$ 5,503,803
Issue of 1.15 million shares	3,507,500
Assumption of debt	1,801,386
Net consideration	10,812,689
Allocated to:	
Drilling and other equipment	4,750,830
Intangibles	300,000
Goodwill	5,761,859
	\$ 10,812,689

The total of 1.15 million common shares of the Fund were issued at an ascribed value of \$3.05 per share. The ascribed per share value was based upon the closing price on the Fund's shares on the Toronto Stock Exchange on the date immediately prior to the date that the letter of intent to purchase Radius was entered into.

4. INVENTORY:

	2004	2003
Parts	\$ 871,316	\$ 230,571
Work in process and finished goods for re-sale	–	384,367
	\$ 871,316	\$ 614,938

5. DRILLING AND OTHER EQUIPMENT:

2004	Cost	Accumulated Depreciation	Net Book Value
Directional drilling equipment	\$ 30,054,954	\$ 10,464,204	\$ 19,590,750
Rental equipment	2,545,911	599,336	1,946,575
Office and computer equipment	898,250	648,960	249,290
Machinery and equipment	525,714	356,365	169,349
Vehicles	292,839	84,932	207,907
	\$ 34,317,668	\$ 12,153,797	\$ 22,163,871

2003	Cost	Accumulated Depreciation	Net Book Value
Directional drilling equipment	\$ 22,280,382	\$ 7,573,873	\$ 14,706,509
Rental equipment	1,685,311	182,957	1,502,354
Office and computer equipment	752,900	535,277	217,623
Machinery and equipment	498,325	294,084	204,241
Vehicles	123,616	31,214	92,402
Deferred costs	294,111	122,550	171,561
	\$ 25,634,645	\$ 8,739,955	\$ 16,894,690

6. RESEARCH AND DEVELOPMENT COSTS:

Development costs capitalized during the year were nil (2003 – \$67,951). Research and development costs charged to earnings during the year were \$835,636 (2003 – \$637,436) that included \$171,561 (2003 – \$122,500) in amortization of deferred development costs and were net of \$145,439 (2003 – \$57,000) in investment tax credits received.

7. BANK INDEBTEDNESS:

The Fund has access to a demand revolving loan facility of up to \$5.0 million. The demand loan would bear interest at the bank prime rate plus .375 percent and is secured by security discussed in Note 9.

8. DISTRIBUTION PAYABLE:

During the year, the Fund paid monthly distributions of \$0.04 per unit totaling \$4,463,565. The Fund declared a distribution of \$0.04 per unit or \$823,994, payable on January 17, 2005. In aggregate, distributions of \$5,287,559 were declared for the year.

9. LONG-TERM DEBT:

	2004	2003
Non-revolving bank loans, with monthly repayments of \$125,000 plus interest. Interest, at the Fund's option is at bank prime rate plus .50 percent or at the bank's banker's acceptance rate plus a stamping fee of 1.25 percent, and is being repaid over a sixty-month period.	\$ 4,775,000	\$ 4,700,000
Less current portion	1,500,000	1,200,000
	\$ 3,275,000	\$ 3,500,000

Principal payments due are as follows:

2005	\$ 1,500,000
2006	1,500,000
2007	1,400,000
2008	300,000
2009	75,000
	4,775,000

The Fund has access to a revolving loan facility of up to \$1,870,000 to be used to assist in the acquisition of drilling and other equipment. The loan would bear interest at the Fund's option at the bank prime rate plus .50 percent or at the banks banker's acceptance rate plus a stamping fee of 1.25 percent.

The demand facility, the non-revolving loan, and this revolving loan facility are secured by a general security over all the assets of the Fund and hereafter acquired by the Fund, assignment of related insurance coverage, and a fixed charge over each asset acquired by the Fund under the revolving loan facility.

10. INCOME TAXES:

- (a) The provision for income taxes differs from the amounts that would be obtained by applying the expected combined federal and provincial statutory income tax rate of 34 percent (2003 – 37 percent) as follows:

	2004	2003
Expected income tax expense	\$ 2,054,835	\$ 2,150,032
Add (deduct):		
Unitholders' distributions	(1,797,770)	–
Non-taxable portion of gains on disposal of assets	(415,849)	(418,000)
Benefit of previously unrecognized tax losses	(74,217)	(182,000)
Other	(65,299)	2,468
	\$ (298,300)	\$ 1,552,500

- (b) Future income taxes arise from temporary differences, which are differences between the tax basis of an asset or liability and its carrying amount in the balance sheet. The tax effects of temporary differences that give rise to significant portions of the future tax assets and liabilities at December 31 are presented below:

	2004	2003
Future income tax liabilities:		
Partnership income	\$ 2,533,960	\$ 1,573,349
Drilling and other equipment	2,170,641	2,068,520
Investment tax credits	441,330	—
Receivable reserves	—	1,122,000
	5,145,931	4,763,869
Future income tax assets:		
Unused income tax losses ⁽¹⁾	(2,301,090)	(707,528)
Share issue costs	(583,930)	(170,789)
Other	(21,711)	(4,552)
	(2,906,731)	(882,869)
Net future income tax liability	\$ 2,239,200	\$ 3,881,000

⁽¹⁾ Tax losses will expire in 2011

11. UNITHOLDERS' CAPITAL:

(a) Authorized and issued units

Pursuant to the terms of the Plan of Arrangement, on July 1, 2004, each PTSI common shareholder received one (1) trust unit of the Fund for each common share held.

Prior to the Plan of Arrangement, the Company was authorized to issue an unlimited number of common voting shares without nominal or par value.

2003	Number	Amount
Common shares of Phoenix Technology Services Inc.		
Balance as at December 31, 2002	17,303,052	\$ 22,542,206
Shares issued pursuant to stock option plan	44,997	35,998
Repurchase of common shares	(439,400)	(570,060)
Dissenting shareholder disbursements (note 11d)	—	(1,383,651)
Balance outstanding, end of year	16,908,649	\$ 20,624,493

2004	Number	Amount
Common shares of Phoenix Technology Services Inc.		
Balance as at December 31, 2003	16,908,649	\$ 20,624,493
Shares issued pursuant to acquisition (note 3)	1,150,000	3,507,500
Shares issued pursuant to stock option plan	574,956	643,357
Escrow shares cancelled (note 11e)	(43,750)	(55,563)
Shares cancelled under the Plan of Arrangement	(18,589,855)	(24,719,787)
Balance as at July 1, 2004	-	\$ -

Fund units of Phoenix Technology Income Fund

Units issued pursuant to Plan of Arrangement, July 1, 2004	18,589,855	24,719,787
Units issued pursuant to unit option plan	10,000	12,628
Units issued pursuant to private placement (note 11f)	2,000,000	7,654,000
Balance outstanding, end of year	20,599,855	\$ 32,386,415

(b) Basic and diluted earnings per unit

2004	Income (numerator)	Units (denominator)	Per unit Amount
Basic earnings per unit:			
Income available to trust unitholders	\$ 6,341,931	18,173,988	\$ 0.35
Diluted earnings per unit:			
Dilutive effect of unit option conversions	-	249,483	
Income available to trust unitholders	\$ 6,341,931	18,423,471	\$ 0.34

2003	Income (numerator)	Units (denominator)	Per unit Amount
Basic earnings per unit:			
Income available to trust unitholders	\$ 4,258,396	17,038,077	\$ 0.25
Diluted earnings per unit:			
Dilutive effect of unit option conversions	-	180,126	
Income available to trust unitholders	\$ 4,258,396	17,218,203	\$ 0.25

(c) Unit options

Prior to the Plan or Arrangement on July 1, 2004, all optionholders of PTSI exercised their vested options to acquire PTSI shares. A total of 455,609 unvested options held by optionholders to acquire PTSI shares were automatically exchanged for options to acquire units of the Fund on substantially the same terms and conditions. During the year, the Fund granted an additional 319,450 unit options at average exercise prices between \$3.22 to \$4.25, with expiration dates between March 15, 2009 to November 15, 2009. During the year a total of 584,928 options were exercised at an exercise price ranging from \$0.80 to \$2.05, and 129,864 options were cancelled. As at December 31, 2004, the Fund had a total of 697,827 options that remain outstanding which expire over a period of 3 to 5 years.

A summary of the status of the plan as at December 31, 2004, is presented below:

	2004		2003	
	Options	Weighted avg. exercise price	Options	Weighted avg. exercise price
Outstanding, beginning of year	1,093,169	\$ 1.09	840,000	\$ 0.80
Granted	319,450	3.73	337,500	1.77
Exercised	(584,928)	1.43	(44,997)	0.80
Cancelled	(129,864)	2.06	(39,334)	0.99
Outstanding, end of year	697,827	\$ 1.94	1,093,169	\$ 1.09
Options exercisable, end of year	13,332	\$ 1.69	254,986	\$ 0.81

The range of exercise prices for options outstanding at December 31, 2004 are as follows:

Options Outstanding			Options Exercisable		
Exercise Price	Number	Weighted avg. remaining contractual life	Weighted avg. exercise price	Number	Weighted avg. exercise price
\$ 0.80	217,509	3.0 yrs	\$ 0.80	—	\$ —
0.85	23,334	3.1 yrs	0.85	6,666	0.85
0.95	—	3.4 yrs	0.95	—	—
1.00	10,000	3.5 yrs	1.00	5,000	1.00
1.08	3,333	3.6 yrs	1.08	—	—
1.55	3,333	3.7 yrs	1.55	—	—
1.56	1,667	3.8 yrs	1.56	—	—
2.05	131,151	4.0 yrs	2.05	—	—
3.22	5,000	4.3 yrs	3.22	1,666	3.22
4.10	10,000	4.7 yrs	4.10	—	—
4.25	292,500	4.9 yrs	4.25	—	—
	697,827	3.8 yrs	\$ 1.95	13,332	\$ 1.69

Effective January 1, 2003, the Fund began prospectively expensing the fair value of unit options granted over the vesting period. In accordance with the prospective method of adoption, the Fund will continue to record no compensation expense for unit options granted prior to January 1, 2003, and will continue to provide pro forma disclosure of the net effect on net earnings and earnings per unit had fair value been expensed. The fair value of options that were exercised for the year ending December 31, 2004 in the amount of \$90,118 has been added to unitholders' capital.

The fair value of each option granted by the Fund was estimated on the date of grant using the Black-Scholes options pricing model with weighted-average assumptions for grants assuming distributions are paid on units, a risk-free interest rate range of 3.5 percent – 5.0 percent, an average life of 3.0 years, and an expected volatility of 50 percent. The amounts computed according to the Black-Scholes pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders.

If the fair value method had been used for options issued in 2002, an additional compensation expense of \$87,000 (2003 – \$87,000) would have been recognized, and the Fund's net earnings and earnings per unit would approximate the following pro forma amounts:

	2004	2003
Net earnings:		
As reported	\$ 6,341,931	\$ 4,258,396
Pro forma	6,254,931	4,171,396
Earnings per unit:		
Basic as reported	\$ 0.35	\$ 0.25
Diluted as reported	0.34	0.25
Basic pro forma	\$ 0.34	\$ 0.25
Diluted pro forma	0.34	0.25

In 2004, the Fund recognized a total compensation expense of \$170,039 for unit options granted in 2004.

(d) **Dissenting shareholders**

In 2002, a group of shareholders, holding in aggregate 994,375 Common Shares of Phoenix Technology Services Ltd. ("PTSL"), a subsidiary of PTSI, exercised their right to dissent under the Plan of Arrangement, and consequently these shares were cancelled. These former shareholders of PTSL were entitled to be paid fair value for their shares. On April 15, 2004, the Fund reached a final settlement with former PTSL shareholders, and these dissenting shareholders received a final payment of \$903,192. In aggregate, a total of \$2,286,843 was paid to the dissenting shareholders during 2003 and 2004. Payments made to these dissenting shareholders and associated costs with the dissent process in an amount equal to the par value related to those shares, were deducted from share capital, net of taxes, in the amount of \$1,383,651 in 2003. In 2004, remaining payments and associated costs of \$1,068,668 were made. As these payments were in excess of the par value of the related shares, \$1,068,668 was adjusted to accumulated earnings.

(e) **Share escrow**

As part of the Radius acquisition, as discussed in note 3, 484,000 shares are held in escrow. Under the terms of the escrow agreement, the escrowed shares will be released as follows:

Date	Number of escrowed shares releasable
March 9, 2005	242,000
September 9, 2005	242,000
	484,000

During the year ended December 31, 2004, 43,750 escrowed shares were cancelled as a result of an escrow condition that was not met.

(f) **Private Placement**

The Fund issued 2,000,000 units pursuant to a private placement for net proceeds of \$7,654,000, including unit issue costs of \$346,000. The unit issue costs are net of the future income tax benefit of \$179,000. The fund units issued under the offering are subject to a four-month hold period.

12. CONTRIBUTED SURPLUS:

	2004	2003
Balance outstanding, beginning of year	\$ 519,416	\$ 340,268
Stock based compensation expense	170,039	83,615
Cancellation of escrow shares (note 11e)	55,563	—
Fair value of options exercised	(90,118)	—
Gain on repurchase of shares	—	95,533
Balance outstanding, end of year	\$ 654,900	\$ 519,416

13. REORGANIZATION COSTS:

The Fund incurred \$657,616 in reorganization costs pursuant to the Plan of Arrangement. These costs are represented by financial advisors, tax advisors, legal and other associated costs, which have been charged to the consolidated statement of earnings.

14. NOTE RECEIVABLE:

A provision of \$1,202,000 was made in 2004 towards the full amount of a note receivable that related to the sale of the Well Director® assets in 2002. Its collection is tied to the performance of future runs of the assets by the purchaser.

15. STATEMENT OF CASH FLOWS:

The changes in non-cash operating working capital items is comprised of the following:

	2004	2003
Decrease (increase) in current assets:		
Accounts receivable	\$ (2,900,135)	\$ (1,145,578)
Inventory	(256,378)	(29,848)
Prepaid expenses	(169,830)	44,185
Investment tax credit	(628,471)	(702,000)
Note receivable	1,944,750	–
Decrease in current liabilities:		
Accounts payable and accrued liabilities	(555,098)	(258,774)
Income taxes payable	(263,925)	(103,621)
Foreign exchange	(112,615)	(1,180,964)
Change in non-cash working capital	\$ (2,941,702)	\$ (3,376,600)

16. SEGMENTED INFORMATION:

The Fund provides directional and horizontal oil and gas well drilling services. The Fund's operating segments have been aligned geographically as follows:

2004	Canada	United States	Total
Revenue	30,491,668	13,354,781	43,846,449
Drilling and other equipment	19,082,322	3,081,549	22,163,871
Goodwill	8,876,351	–	8,876,351

2003	Canada	United States	Total
Revenue	26,695,835	8,646,686	35,342,521
Drilling and other equipment	13,296,874	3,597,816	16,894,690
Goodwill	3,744,731	–	3,744,731

17. COMMITMENTS:

The Fund is committed to the following minimum payments under operating leases for equipment and premises:

2005	\$ 704,793
2006	222,332
2007	13,285

During the year, the Fund paid \$827,525 (2003 – \$1,000,750) for various operating leases.

18. RELATED PARTY TRANSACTIONS:

During the year the Fund was charged \$623,977 (2003 – \$209,787) for the provision of various legal services from a director's firm of which he is a partner.

During the year the Fund received \$59,932 (2003 – nil) for various services performed and \$10,600 (2003 – nil) for the sale of various capital equipment from companies controlled by an officer and major unitholder of the Fund.

During the year the Fund paid nil (2003 – \$50,000) for the provision of various advisory services to a firm owned by an officer of the Fund.

These transactions were completed in the normal course of operations on normal market terms and are measured at the exchange amounts.

19. FINANCIAL INSTRUMENTS:

(a) Credit risk

The Fund is exposed to normal credit risks of its customers that exist within the oil and gas exploration and development industry.

(b) Fair values of financial instruments

The carrying values of accounts receivable, accounts payable and accrued liabilities, and income taxes payable approximate their fair value due to the relatively short periods to maturity of the instruments. The fair value of long-term debt included in the consolidated balance sheet approximates fair values as the indebtedness is subject to floating rates of interest.

(c) Interest rate risk

The Fund manages its exposure to interest rate risk through floating rate borrowings.

20. CONTINGENCY:

At December 31, 2004, the Fund was subject to a legal claim associated with a contractual dispute from a former consultant. Although the outcome of this matter is not determinable at this time, the Fund believes the claim will not have any material adverse effect on the Fund's financial position or results of its operations.

CORPORATE INFORMATION

STOCK EXCHANGE LISTING

Trust Units of Phoenix Technology Income Fund are listed on the TSX under the trading symbol "PHX.UN".

CORPORATE INFORMATION

Board of Directors

John M. Hooks
Elson J. McDougald
Jeff G. Lawson
James K. Gray, O.C.
Randolf ("Randy") M. Charron
J. Cameron Bailey

Officers

John Hooks,
President and CEO

Cameron Ritchie,
Sr. Vice President Finance and CFO

Reid Hansen
Sr. Vice President

Myron Tétreault,
General Counsel and Corporate Secretary

Corporate Office

630, 435 – 4th Avenue S.W.
Calgary, Alberta T2P 3A8
Telephone: (403) 543-4466
Facsimile: (403) 543-4485
E-mail: sales@phoenixcan.com
Website: www.phoenixcan.com

Research & Development and Operations Centre

11560 – 42nd Street S.E.
Calgary, Alberta T2Z 4E1
Telephone: (403) 236-1394
Facsimile: (403) 236-1624

Nevis Energy Services Inc.

Houston Location

1724-B Townhurst Drive,
Houston, Texas 77043
Telephone: (713) 827-8302
Facsimile: (713) 827-8348

Casper Location

1346 Willer Drive,
Casper, Wyoming 82604

Legal Counsel

Burnet, Duckworth & Palmer LLP
Calgary, Alberta

Auditors

KPMG LLP
Calgary, Alberta

Bankers

HSBC Bank Canada
Calgary, Alberta

Transfer Agent

Computershare Trust Company of Canada
Calgary, Alberta

PHX.UN

